SB 112

Department of Legislative Services

Maryland General Assembly
2009 Session

FISCAL AND POLICY NOTE

Senate Bill 112 (Senator Stone)
Budget and Taxation

Income Tax - Subtraction Modification - Military Retirement Income

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This bill expands the existing military retirement income subtraction modification by exempting 100% of specified military retirement income.

The bill takes effect July 1, 2009 and applies to tax years 2009 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by $64.1 million in FY 2010 due to additional military retirement income being exempted. Future year revenues reflect annualization and estimated number of eligible taxpayers. Expenditures are not affected.

($ in millions)	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
GF Revenue	($64.1)	($44.5)	($46.3)	($48.2)	($50.3)
Expenditure	0	0	0	0	0
Net Effect	($64.1)	($44.5)	($46.3)	($48.2)	($50.3)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Local government revenues decrease by $41.8 million in FY 2010 and $32.8 million by FY 2014. Expenditures are not affected.

Small Business Effect: None.

Analysis

Current Law: Chapter 226 of 2006 expanded a $2,500 military retirement income subtraction that was limited to enlisted military members with a federal adjusted gross income of $22,500 or less. Under Chapter 226, an individual may exempt the first

$5,000 of military retirement income from State taxation if the retirement income resulted from service in an active or reserve component of the armed forces of the United States or in the Maryland National Guard.

Under Chapter 226, retirees from active duty with the Commissioned Corps of the Public Health Service, National Oceanic and Atmospheric Administration (NOAA), or the Coast and Geodetic Survey qualified for the subtraction modification, but only if separated from service after July 1, 1991. Chapter 553 of 2007 eliminated this restriction and allowed all the individuals described previously to qualify for the subtraction modification, beginning tax year 2007, without regard to the date of separation from employment.

Military retirement income exempted under this provision cannot be counted towards the State pension exclusion.

Maryland law also provides a pension exclusion subtraction for individuals who are at least age 65 or who are totally disabled. Up to a specified maximum amount of taxable pension income ($24,000 maximum for 2008) may be exempt from tax. The maximum exclusion allowed is indexed to the maximum annual benefit payable under the Social Security Act and is reduced by the amount of any Social Security payments received. The pension exclusion has been a part of the Maryland income tax since 1965.

The "Social Security offset" is the reduction in the maximum pension exclusion allowed under the current law by the individual. The Social Security offset was established at the same time as the pension exclusion. Given that Social Security benefits are exempt from Maryland income tax, the offset works to equalize the tax treatment of individuals who receive their retirement benefits from different sources by reducing the amount of allowable exclusion by the amount of Social Security benefits received.

Social Security benefits and benefits received under the federal Railroad Retirement Act are totally exempt from the Maryland income tax, even though they may be partly taxable for federal income tax purposes. In addition to the special treatment of Social Security and other retirement income, other income tax relief is provided to senior citizens regardless of the source of their income. Each individual age 65 or older can also earn more income without being required to file taxes. The additional exemption amount allowed for elderly or blind individuals is $1,000. This amount is in addition to the regular personal exemption available to all taxpayers.

Background: Chapter 94 of 2003 established the Task Force to Study the Financial Impact of Retired Military Service Personnel on the Economy of the State. The task force issued its final report in December 2003. Among its findings was that in 2000 there were approximately 42,600 military retirees living in Maryland. The task force estimated that median household income of military retirees was $71,484 compared with a median household income of $42,151 for all Maryland households. The average income reported by military retirees was $83,435, of which $18,266 was attributable to retirement pay and $65,169 was derived from second career employment and other sources. These military retiree households were estimated to pay approximately $163 million in State and local income taxes.

According to the Defense Manpower Data Center (DMDC), 46,401 military retirees received a total of $94.5 million in retirement income from the Department of Defense in September 2007. This includes individuals who served in the Army (including Maryland National Guard), Navy, Marines, and Air Force. On an annualized basis, the retirement income totaled approximately $1.13 billion. This amount reflects 3,790 retirees who received approximately $30.1 million annually in disability payments. Disability payments resulting from active service in the armed forces, NOAA, Public Health Service, or foreign service are not taxable for State income purposes because they are exempted from federal taxation. In addition, DMDC reports that 1,165 Coast Guard retirees received retirement income (including disability pay) in the amount of approximately $27.3 million on an annual basis. Data on total nondisability pay for Coast Guard retirees were unavailable. Coast Guard retirees are paid by the Department of Homeland Security.

Exhibit 1 lists the total retirement pay (including disability pay) received by Maryland military retirees by branch of service.

According to the Office of Commissioned Corps Force Management Information System, 762 Maryland residents who retired from the Commission Corps of the Public Health Service received a total of $52.1 million, or an average of $68,312, in retirement income during 2005.

State Revenues: Additional retirement income can be exempted beginning in tax year 2009. As a result, general fund revenues will decrease by approximately $42.2 million in tax year 2009 and $43.7 million in tax year 2010. It is assumed that most taxpayers will adjust withholdings and estimated payments. As a result, fiscal 2010 revenues will decrease by both the change in tax year 2009 revenues and also by one-half of tax year 2010, resulting in a decrease of approximately $64.1 million in fiscal 2010.

Exhibit 2 shows the projected State and local revenue loss from exempting military retirement income. Annualization losses reflect the estimated number of eligible retirees, increases in retirement income, and the estimated cost of the current subtraction modification and pension exclusion provided for military retirement income.

This estimate is based on the number of retirees and amount of retirement income received by State residents as reported by DMDC and the Office of Commissioned Corps Force Management Information System, estimated cost of the current military retirement subtraction modification, and interaction with the State pension exclusion.

Exhibit 1
Retirement Payments by Branch of Service
2007

Branch	Retirees	Received Pension	Annual ($ in Millions)	Average
Army	18,483	17,166	$405.3	$23,610
Navy	14,509	13,610	355.6	26,130
Marines	2,478	2,141	54.8	25,580
Air Force	14,408	13,484	317.8	23,570
Subtotal	**49,878**	**46,401**	**$1,133.5**	**$24,430**
Coast Guard	1,215	1,165	27.3	23,440
Total	**51,093**	**47,566**	**$1,160.8**	**$47,870**

Source: Defense Manpower Data Center

Exhibit 2
Projected State and Local Revenue Loss – Military Exemption
($ in Millions)

Fiscal	State	Local	Total
2010	$64.1	$41.8	$105.9
2011	44.5	29.1	73.6
2012	46.3	30.2	76.5
2013	48.2	31.4	79.6
2014	50.3	32.8	83.1

Local Fiscal Effect: Local government revenues would decrease by 3% of the net change in State tax liability in tax year 2009 resulting from the provisions of the bill. In fiscal 2010, the decrease will total approximately $41.8 million. Exhibit 2 lists the local income tax revenue impact by fiscal year.

Additional Information

Prior Introductions: Identical bills were introduced in the 2007 and 2008 sessions. SB 967 of 2007 and HB 549 of 2008 were not reported from the Senate Budget and Taxation Committee and House Ways and Means Committee. In addition, similar bills were also introduced in the 2007 and 2008 sessions. SB 625 and SB 315 of 2008 were not reported from the Senate Budget and Taxation Committee. SB 445 of 2007 was withdrawn and HB 176 of 2007 was not reported from the House Ways and Means Committee.

Cross File: None.

Information Source(s): U.S. Census Bureau, Defense Manpower Data Center, Department of Defense (Office of Actuary), National Oceanic and Atmospheric Administration, Office of Commissioned Corps Force Management Information System, Comptroller's Office, Department of Legislative Services

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